DOCKET SECTION

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

POSTAL RATE AND FEE CHANGES, 1997) Docket No. R97-1

TESTIMONY OF

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CONCERNING RATES FOR NONPROFIT STANDARD MAIL (A)

ON BEHALF OF

ALLIANCE OF NONPROFIT MAILERS

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AUTOBIOGRAPHICAL SKETCH

My name is John Haldi. I am President of Haldi Associates, Inc., an economic and management consulting firm with offices at 680 Fifth Avenue, New York, New York 10019. My consulting experience has covered a wide variety of areas for government, business and private organizations, including testimony before Congress and state legislatures.

In 1952, I received a Bachelor of Arts degree from Emory University, with a major in mathematics and a minor in economics. In 1957 and 1959, respectively, I received an M.A. and a Ph.D. in economics from Stanford University.

From 1958 to 1965, I was assistant professor at the Stanford University Graduate School of Business. In 1966 and 1967, I was Chief of the Program Evaluation Staff, U.S. Bureau of Budget. While there, I was responsible for overseeing implementation of the Planning-Programing-Budgeting (PPB) system in all non-defense agencies of the federal government. During 1966 I also served as Acting Director, Office of Planning, United Stated Post Office Department. I was responsible for establishing the Office of Planning under Postmaster General Lawrence

O'Brien. I established an initial research program, and screened and hired the initial staff.

I have written numerous articles, published consulting studies, and co-authored one book. Included among those publications are (i) an article "The Value of Output of the Post Office Department," which appeared in *The Analysis of Public Output* (1970); (ii) a book, *Postal Monopoly: An Assessment of the Private Express Statutes*, published by the American Enterprise Institute for Public Policy Research (1974); (iii) an article, "Measuring Performance in Mail Delivery," in *Regulation and the Nature of Postal Delivery Services* (1992); and (iv) an article "Cost and Returns from Delivery to Sparsely Settled Rural Areas" in *Managing Change in the Postal and Delivery Industries* (1997; with L. Merewitz).

I have testified as a witness before the Postal Rate Commission in Docket Nos. MC96-3, MC95-1, R94-1, SS91-1, R90-1, SS86-1, R84-1, R80-1, MC78-2 and R77-1. I also have submitted comments in Docket No. RM91-1.

PURPOSE AND SUMMARY OF TESTIMONY

The purpose of this testimony is to analyze the unusually large increase in the average cost of nonprofit non-ECR mail that the Postal Service (i) contends occurred between FY95 and FY96, (ii) carries forward to the Test Year in this case, and (iii) reflects in extraordinarily large rate increases for several rate categories of nonprofit mail.

In Section I, I show that the Postal Service has proposed disproportionate rate increases for nonprofit non-ECR mail, compared with the corresponding commercial rate category, and that the disparity is due to differences in costs attributed by the Postal Service to nonprofit and commercial mail.

In Section II, I show that these disparities in reported costs cannot be explained by trends in presort condition, shape, automation, dropship entry, weight, or any other cost-causing characteristic of nonprofit mail since the last omnibus rate case.

In Section III, I discuss the likelihood, covered in more detail in the separate testimony of Time/Warner witness Halstein Stralberg, that the labor costs attributed by the Postal Service to nonprofit mail may be

inflated by the phenomenon of "automation refugees" — workers rendered surplus by automation, but remaining on the Postal Service payroll and reassigned to manual operations.

In Section IV, I identify several nonsensical IOCS tallies for Nonprofit Standard (A) Mail, and explain why these obviously erroneous tallies cast doubt on the integrity of the overall IOCS system, and should be eliminated from the nonprofit cost base.

In Section V, I explain why the Postal Service's failure to calibrate or synchronize its cost and volume data has inflated the unit cost attributable to nonprofit Standard (A) Mail. Specifically, a significant volume of the Standard (A) mail for which nonprofit mailers pay commercial rates appears to be reported in the RPW system as commercial mail, but reported in the IOCS system as nonprofit mail. I also explain how the Commission should correct for this error.

Finally, in Section VI, I explain why the TRACS system tends to attribute an inflated share of the costs of purchased transportation to nonprofit mail, and how the Commission can mitigate this error.

I. INTRODUCTION

The Disproportionately Large Rate Increases Proposed for Nonprofit Regular Mail

In this docket, the Postal Service has proposed rates for Nonprofit Standard Mail (A) Regular (Bulk Nonprofit ("BNP") Other) mail that increase sharply, while proposing only a small overall increase in rates for the corresponding commercial rate subclass (Standard Mail (A) Regular, former Bulk Regular Rate ("BRR") Other).[1] The **letter** rates proposed by the Postal Service for Standard Mail (A) Regular illustrate the deviation between nonprofit and commercial rates in this docket. As can be seen from Table 1, letter rates within the Presort Category exhibit the sharpest contrast; Nonprofit Standard Mail (A) Regular letters **up 19 percent**, Standard Mail (A) Regular letters **down slightly**. On a percentage basis, the changes in rates proposed for Automation letters, a fairly homogeneous category, also deviate significantly (except for carrier route automation letters).

[1] At the same time, the Postal Service proposes downward revisions for Nonprofit ECR rates, while rates proposed for the commercial rate ECR subclass increase modestly.

Table 1

Standard Mail (A) Regular
Postal Service Proposed Letter Rates

	NONPROFIT RATE			COMMERCIAL RATE		
	Old Step 6	New Step 6	Percent Change	Existing	Proposed	Percent Change
PRESORT CATEGORY						
Basic Presort Letter	13.8	16.5	19.57%	25.6	24.7	-3.52%
3/5 Presort Letter	12.0	14.3	19.17%	20.9	20.9	0.00%
AUTOMATION CATEGORY						
Basic Auto Letter	10.5	12.4	18.10%	18.3	18.9	3.28%
3-digit Auto Letter	10.1	11.2	10.89%	17.5	17.6	0.57%
5-digit Auto Letter	8.8	9.5	7.95%	15.5	16.0	3.23%
Cr Rte Auto Letter	8.5	9.2	8.24%	14.6	15.7	7.53%

The Cause Of the Disprotionate Rate Increases: Disproportionate Increases in Attributable Costs Reported By the Postal Service

Markups. Under the Revenue Forgone Reform Act, the markup on each Nonprofit Standard Mail (A) subclass is set at one-half the markup of the corresponding Standard Mail (A) subclass. Consequently, when proposed Nonprofit Standard Mail (A) rates deviate from the corresponding Standard Mail (A) rate category, it follows that the deviation is not caused by differential treatment with respect to the markup.

Costs. In theory, a deviation in direction and magnitude of proposed changes in the Standard Mail (A) rates and the Nonprofit Standard Mail (A)

rates should reflect an underlying deviation in costs, and in FY96, nonprofit costs did indeed show an abnormal increase. This is confirmed by the data in Table 2, which show average unit costs for Standard Mail (A) and Nonprofit Standard Mail (A) Regular (formerly third-class bulk) since 1992.

In Table 2, the most critical comparisons for purposes of this testimony are between columns 1 and 2, and for FY95 and FY96. From FY95 to FY96, the unit cost for Bulk Regular Rate (BRR), "other" (the predecessor to Standard Mail (A) Regular) declined modestly, by 0.1 cent.[2] At the same time, from FY95 to FY96 the unit cost for Bulk Nonprofit (BNP) "other" (the predecessor to Nonprofit Standard Mail (A) Regular) increased by an abnormally large amount, 0.8 cent.[3] Considered together, these two changes narrowed the difference in unit cost between BRR "other" and BNP "other" by 0.9 cents.

FY96 was unusual in the following respect. From FY92 through FY95, whenever the average unit cost for BRR "other" increased or decreased, the unit cost of BNP "other" also increased or decreased,

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[2] This small decline is reflected by the modest proposed changes in rates for Standard Mail (A) Regular shown in Table 1.

[3] The 0.8 cent increase in unit cost represented an increase of almost 8 percent in one year. As can be seen from Table 1, some of the proposed letter rates magnify this increase in unit cost.

whereas in FY96 the unit cost for BRR "other" decreased slightly while BNP "other" skyrocketed upward.

The unusually large increase in unit costs in FY96 carries through to Base Year 1996, which is then rolled forward to Test Year 1998. That is, the relationship between Nonprofit Standard Mail (A) Regular and Standard Mail (A) Regular rates is preserved more or less unaltered by the transformations that take place in the Postal Service models. This testimony focuses, therefore, on the extraordinary increase in the unit cost of BNP "other" mail between FY95 and FY96, both in absolute amount and in comparison to BRR "other."

Table 2

Third Class/Standard Mail (A)
Average Unit Cost
(cents)

Fiscal Year	BRR Other (1)	BNP Other (2)	BRR Carrier Route (3)	BNP Carrier Route (4)
1992	15.3	10.8	6.9	5.0
1993	14.6	10.4	6.1	4.9
1994	14.2	10.2	6.1	4.5
1995	14.7	10.4	6.4	4.4
1996	14.6	11.2	6.4	4.8

Source: USPS, Cost and Revenue Analysis Report, Statistics by Class of Mail, p. 12.

II. THE INABILITY OF CHANGES IN THE PROFILE OF STANDARD MAIL (A) OTHER, 1995-1996 TO EXPLAIN THE REPORTED INCREASE IN ATTRIBUTABLE COSTS

As a first step, the profile of Nonprofit Standard Mail (A) was investigated, to ascertain whether any significant changes had occurred in the mix; *i.e.*, to see whether an influx of more expensive, difficult-to-handle pieces might have caused the unit cost to increase. In addition, changes in the profile of Standard Mail (A) Regular were examined to see if they would account for the disparate change in unit cost. Between FY95 and FY96, the volume of Nonprofit Standard Mail (A) Regular increased by less than 1.0 percent (0.75 percent), and the profile, or "mix," generally can be described as fairly stable. However, the changes that did occur surprisingly increased the share of less expensive mail and reduced the share of more expensive mail. To anticipate the results that follow, from a detailed analysis of the billing determinants no change is discernable that would explain the sharp increase in the unit cost of Nonprofit Standard Mail (A) Regular between FY95 and FY96, especially when the unit cost of the corresponding commercial subclass declined slightly.

Presort Condition

In FY96, the share of **3/5-Digit presort Nonprofit Standard Mail (A) Regular** presort mail **increased** slightly, by 1.4 percent, from 66.7 to 68.1 percent. The share of Nonprofit **Basic** (Required) presort **experienced a corresponding decline**, from 33.3 to 31.9 percent; see Table 3. This change in the mix of Nonprofit Standard Mail (A) Regular, while slight, is in the direction of **less costly** mail. It does nothing to explain the surge in unit cost in FY96.

Standard Mail (A) Regular experienced a similar, but slightly smaller, shift to 3/5-Digit presort. The year-to-year change does nothing to explain the disparate movement in cost and rates as between Standard Mail (A) Regular, Standard Mail (A) and Nonprofit Standard Mail (A) Regular. It is worth noting, however, that Regular rate has a somewhat higher percentage of 3/5-Digit presort mail (80.8 versus 68.1 percent). Thus, Nonprofit Standard Mail (A) Regular had more Basic presort mail, which required more sortation, including manual sortation.[4]

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[4] This is pertinent to the issue of mail processing productivity and automation refugees, discussed in Section III, *infra.*

Table 3

Standard Mail (A) Regular
Distribution by Presort Level
(percent)

NONPROFIT	FY95	FY96	Change
Basic (Required)	33.4%	31.9%	-1.5%
3/5-Digit	66.6	68.1	+1.4%
COMMERCIAL			
Basic (Required)	20.3	19.2	-1.1
3/5-Digit	79.7	80.8	+1.1

Source: FY95 and FY96 Billing Determinants

Shape

In FY96, the share of **letter-sized Nonprofit Standard Mail (A) Regular** Basic (Required) presort mail **increased** by 1.1 percentage points. In the 3/5-Digit presort category, the share of **letter-sized Nonprofit Standard Mail (A) Regular also increased slightly,** by 0.5 percentage points; see Table 4. Clearly, **the share of more expensive-to-process flats did not increase.** Thus, the slight change in the mix of shapes within Nonprofit Standard Mail (A) Regular does not account for the sharp increase in unit cost in FY96.

Within Standard Mail (A) Regular, the share of letter-sized mail within the Basic (Required) presort level increased by 1.8 percentage points. At the 3/5-Digit level, however, letter-sized mail showed a decrease of 1.0 percentage points. Overall, the share of non-letters in Standard Mail (A) Regular increased slightly, while the share of Nonprofit Standard Mail (A) Regular non-letters decreased slightly. Consequently, changes in shape do nothing to help explain why Nonprofit Standard Mail (A) Regular costs shot up in FY96, while costs of the corresponding commercial subclass declined slightly.

Table 4

Standard Mail (A) Regular
Distribution by Shape
(percent)

NONPROFIT	FY95	FY96	Change
Basic (regular)			
Letters	83.7%	84.8%	+1.1%
Non-letters	16.31	15.21	-1.1%
3/5-Digit			
Letters	80.9	81.4	+0.5
Non-letters	19.1	18.6	-0.5
Total			
Letters	81.8	82.0	+0.2
Non-letters	18.2	18.0	-0.2
COMMERCIAL			
Basic (regular)			
Letters	69.1	71.7	+1.8
Non-letters	30.9	28.3	-1.8
3/5-Digit			
Letters	60.8	59.8	-1.0
Non-letters	39.2	40.2	+1.0
Total			
Letters	62.5	62.1	-0.4
Non-letters	37.5	37.9	+0.4

Source: FY95 and FY96 Billing Determinants

Automation

In FY96, the **percentage of prebarcoded Nonprofit Standard Mail (A) Regular** letter-shaped mail **increased** in both Basic (Required) and the 3/5-Digit presort categories, by 4.8 and 10.5 percent, respectively; see Table 5. **The percentage of prebarcoded nonprofit flats also increased** in both the Basic (Required) and the 3/5-Digit presort categories, by 3.17 and 5.59 percent, respectively. It would have been desirable for nonprofit mailers to have prebarcoded an even higher percentage of their mail. Nevertheless, the surge in unit costs in FY96 is not explained by the gradually expanding base of prebarcoded letters and flats.

Within Standard Mail (A) Regular, the percent of prebarcoded letters increased by 9.4 percent, about the same increase (9.02 percent) as Nonprofit Standard Mail (A) Regular letters. Prebarcoded flats increased 6.4 percent, versus 5.3 percent for nonprofit flats.[5]

Reclassification effect. On July 1, 1996, an unusual event occurred that created a potentially significant difference between Standard Mail (A) and Nonprofit Standard Mail (A): Reclassification. Changes resulting from Docket No. MC95-1 became fully effective on July 1.

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[5] Significantly, Standard Mail (A) "commercial" mailers prebarcode a higher percentage of both letters and flats than do Nonprofit mailers. This is pertinent to the issue of mail processing productivity and automation refugees, discussed in Section III, *infra.*

However, while mail make-up changes became mandatory for all mailers, new rate discounts applied only to Standard Mail (A). They did not apply to Nonprofit Standard Mail (A). Thus, new mail make-up requirements were imposed on nonprofit mailers without corresponding discounts. Reclassification for nonprofit mail was still pending at the time. The Governors' decision in Docket No. MC96-2 was not made until August 5, 1996, and rate changes did not become effective for Nonprofit Standard Mail (A) until October 6, 1996, after the end of FY 1996.

The extent to which Standard Mail (A) Regular mailers increased their prebarcoding efforts in anticipation and because of reclassification changes is not known. However, reclassification was undertaken because it was expected to have a major impact. Docket No. MC95-1 was filed on March 24, 1995 and ***commercial rate mailers had up to 15 months*** to anticipate and prepare for reclassification, which became effective on July 1, 1996. Docket No. MC96-2 was not filed until April 4, 1996, so ***nonprofit mailers had only 6 months*** to anticipate and prepare for reclassification, which became effective on October 6, 1996.[6]

[6] In some cases nonprofit mailers were given only four months notice when they were told their mail would have to conform to Standard Mail (A) preparation requirements on July 1 without any corresponding discounts.

Table 5

Standard Mail (A) Regular
Share of Automation Discount Mail
(percent)

	FY95	FY96	Change
NONPROFIT			
Letter Automation Discount			
Basic (Required) Presort	10.3%	15.2%	+ 4.9%
3/5-Digit Presort	39.8	50.3	+10.5
All letters	29.8	38.8	+ 9.0
Flat Automation Discount			
Basic (Required) Presort	3.5	6.7	+ 3.2
3/5-Digit Presort	40.9	46.5	+ 5.6
All Flats	29.7	35.0	+ 5.3
COMMERCIAL			
Letter Automation Discount			
Basic (Required) Presort	17.6	30.5	+12.9
3/5-Digit Presort	52.2	63.5	+8.2
All letters	46.8	56.2	+9.4
Flat Automation Discount			
Basic (Required) Presort	7.6	9.9	+2.3
3/5-Digit Presort	64.1	69.5	+5.5
All Flats	54.6	61.0	+6.4

Source: FY95 and FY96 Billing Determinants

Dropship Entry

A very small percent of Nonprofit Standard Mail (A) Regular Basic (Required) presort mail is drop shipped to BMCs and SCFs. In FY96, the drop ship share climbed almost imperceptibly, by 0.2 percent; see Table 6. The share of nonprofit 3/5-Digit-presort mail drop shipped to BMCs and SCFs increased by 2.2 percent, from 22.8 to 25.0 percent. Year-to-year, the drop ship profile was changed only slightly. The surge in unit cost for Nonprofit Standard Mail (A) Regular in FY96 is not explained by the small increases in drop shipment that did occur.

Within Standard Mail (A) Regular, the percent of mail that is drop shipped increased by 2.2 percent, in tandem with Nonprofit Standard Mail (A) Regular, which also showed an overall average increase of 2.2 percent. The one significant feature here is that Standard Mail (A) Regular mailers drop ship somewhat more of their mail than do Nonprofit Standard Mail (A) Regular mailers — 41.3 versus 25.0 percent.[7]

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[7] This is pertinent to the issue of mail processing productivity and automation refugees, discussed in Section III, *supra*.

Table 6

Standard Mail (A) Regular
Proportion Drop Shipped to BMC and SCF
(percent)

	FY95	FY96	Change
NONPROFIT			
Basic			
BMC	0.9%	1.0%	+0.1%
SCF	2.2	2.3	+0.1
Total drop shipped	3.1	3.3	+0.2
3/5-Digit:			
BMC	13.3	15.9	+2.6
SCF	19.3	19.3	0.0
Total drop shipped	32.6	35.2	+2.6
All Nonprofit Regular			
BMC	9.2	11.2	+2.0
SCF	13.6	13.8	+0.2
Total drop shipped	22.8	25.0	+2.2
COMMERCIAL			
Basic			
BMC	3.1	4.4	+1.3
SCF	1.0	1.6	+0.6
Total drop shipped	4.1	6.0	+1.9
3/5-Digit			
BMC	34.0	34.7	+0.7
SCF	14.0	15.0	+1.0
Total drop shipped	48.0	49.7	+1.7
All Regular Rate Mail			
BMC	27.7	28.9	+1.2
SCF	11.4	12.4	+1.0
Total drop shipped	39.1	41.3	+2.2

Source: FY95 and FY96 Billing Determinants. Percentages are based on volume drop shipped.

Weight

The average weight of Nonprofit Standard Mail (A) Regular scarcely changed between FY95 and FY96; see Table 7. The average weight of Standard Mail (A) Regular declined slightly, by 3.6 percent. This change in weight may have been a small contributing factor in restraining costs for Standard Mail (A) Regular.

Table 7

Standard (A) Regular Mail
Average Weight
(ounces)

	FY95	FY96	Change
NONPROFIT	1.07	1.08	+0.01
COMMERCIAL	2.23	2.15	-0.08

Source: CRA

Conclusion

As noted at the outset, nothing in year-to-year changes in the billing determinants explains why the unit cost of Nonprofit Standard Mail (A) Regular has increased sharply, while the corresponding unit cost of Standard Mail (A) Regular declined by a slight amount. Both are handled in the same manner, and mail processing cost models assume the same productivity (or lack thereof) for both.

III. MAIL PROCESSING PRODUCTIVITY AND THE AUTOMATION REFUGEE PROBLEM

Since billing determinants do not provide any insight concerning the sharp increase in unit cost of Nonprofit Standard Mail (A) Regular, a detailed analysis of the attributable costs is required. Attributable costs for each cost segment in FY95 and FY96 are shown in Table 8.

Total costs were up 8.7 percent, while volume was up only 0.8 percent. Unit cost was up on average by 0.81 cents, or 7.8 percent, reflecting the small increase in volume concurrent with the large increase in total cost.

In absolute amount, the biggest increase by far was for clerks and mailhandlers, $37,478,000. The second largest increase was purchased transportation, $11,449,000. Without piggybacks, these two direct cost segments accounted for almost 60 percent of the total year-to-year increase. With piggybacks, they account for over three-fourths of the total increase. That is, the increase in mail processing and transportation cost accounts for over 0.60 cents of the total 0.81 cents increase in unit cost. Consequently, the focus of inquiry is on these two cost segments.

The unusual increase in mail processing cost for Nonprofit Standard Mail (A) Regular can be explained by at least three different hypotheses.

- Nonprofit Standard Mail (A) Regular was handled at lower productivity in FY96.
- IOCS tallies of Nonprofit Standard Mail (A) Regular are overstated.
- Integrity of the Postal Service data systems that report Standard Mail (A) volume and costs eroded significantly during FY96.

The first hypothesis is discussed in this section. The other two hypothesis are discussed in Sections IV and V, respectively. Transportation cost is discussed separately in Section VI.

The Lower Productivity Hypothesis

As indicated in Tables 5 and 6, nonprofit mailers barcode and drop ship a lower percentage of their mail than do regular rate mailers, and thus a larger portion of nonprofit mail must be handled manually. In other words, a lower percentage of Nonprofit Standard Mail (A) Regular qualifies for worksharing discounts, which means that less of it bypasses the Postal Service network.

The increase in unit cost for Nonprofit Standard Mail (A) Regular is consistent with hypotheses that (i) the Postal Service has "automation refugees" and (ii) productivity has declined and continues to decline in

areas where mail is not handled by automation or mechanization. That is, the Postal Service has an excess of displaced clerks and mailhandlers who are kept busy (at reduced productivity rates) processing mail that is not automated and does not (or can not) take advantage of drop-shipment to bypass the Postal network.

Under changing conditions, such as those being experienced by the Postal Service as it gradually automates mail processing, the IOCS is capable of producing odd, counterintuitive and incorrect results, as explained in greater detail by witness Stralberg.[8] For example, mail that is handled manually, at constant productivity, will have an increasing proportion of direct handling tallies. In turn, the higher ratio of direct tallies will cause an increase in the share of "not handling" tallies and costs assigned to manually sorted mail.[9] In other words, without any cost-driving change in manually sorted mail, total costs (and unit costs) may nevertheless be deemed to have increased.

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[8] TW-T-1

[9] As automation has progressed, the share of "not handling" tallies has increased substantially, with a corresponding decline in the share of direct tallies. With yet further automation, the day may come when direct tallies represent only fewer than 25 percent of all tallies, and by then (if not before) a better way of estimating costs will become a necessity.

The sharp increase in mail processing cost, ***relative to direct carrier costs***, is also fully consistent with the hypothesis that the Postal Service has excess mail processing labor, or "automation refugees," coupled with lower mail processing productivity. That is, costs are not increasing across-the-board, but only in the mail processing area.

Finally, rates for the Basic and 3/5-Digit presort categories show the greatest rate increase, along with the Automation Basic category; see Table 1.[10] These are the categories that require the greatest amount of handling. The higher-than-average rate increases reflect higher-than-average cost increases, which reflect productivity changes below average (*i.e.*, a decline in productivity).

This hypothesis identifies an unfortunate and potentially serious consequence of automation. Namely, to the extent that it explains the sharp increase in the unit cost of nonprofit mail, it means that nonprofit mail is a victim (along with periodicals) of being allocated too large a share of "not handling" tallies and/or inefficient management. The Commission and the Postal Service need to find a better way of distributing the increasing proportion of "not handling" tallies that, seemingly, are an inevitable byproduct of automation.

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[10] Exhibits USPS-29A and B indicate that nonprofit letters contained a higher proportion of "non-upgradable" letters than regular rate.

Table 8

Nonprofit Standard Mail (A) Regular Costs
By Cost Segment
FY95 and FY96
($,000)

Segment	FY95	FY96	Change	Percent
Postmasters	5,689	5,788	99	1.7%
Supervisors & Technicians	53, 037	57,827	4,790	9.0
Clerks & Mailhandlers	405,102	442,580	37,478	9.2
Clerks CAG-K Offices	152	91	-61	-40.0
City Delivery Carriers-Office	120,441	118,204	-2,237	-1.8
City Delivery Carriers-Street	73,047	77,914	4,867	6.6
Vehicle Service Drivers	4,798	5,080	282	5.8
Special Service Messengers	0	0	0	0.0
Rural Carriers	57,530	61,886	4,356	7.3
Custodial & Maintenance Services	38,495	42,454	3,959	10.2
Motor Vehicle Services	2,102	2,394	292	13.9
Miscellaneous Operating Costs	212	238	26	12.3
Purchased Transportation	39,486	50,937	11,451	29.0
Building Occupancy	21,806	23,567	1,761	8.0
Supplies and Services	26,775	32,698	5,923	22.0
Research & Development	0	0	0	0.0
Administrative & Regional Operation	52,831	61,251	8,420	16.0
General Management Systems	0	0	0	0.0
Other Accrued Expenses	60,094	61,810	1,716	2.8
Total	961,597	1,044,659	83,162	8.7%
Volume (000)	9,230,806	9,300,466	69,660	0.8%
Average Cost (cents)	10.42	11.23	0.81	7.8%

Source: CRA.

IV. ANOMALOUS IOCS TALLIES FOR NONPROFIT STANDARD MAIL (A)

Mail processing costs for each subclass reflect the IOCS tallies of clerks and mailhandlers recorded for that subclass. Accordingly, the FY96 IOCS tallies for Nonprofit Standard Mail (A) Regular were analyzed to see whether any reason for the unusually large increase in cost could be ascertained; *i.e.*, whether any reason existed to challenge the accuracy of the tallies.

Total tallies. In FY96, 2,568, IOCS tallies were recorded for Nonprofit Standard Mail (A). Of these 2,393 were for Nonprofit Standard Mail (A) Regular, and 175 were for Nonprofit Standard Mail (A) ECR; see Table 9. Direct mail processing accounted for most of the tallies (2,533 out of 2,568). The focus of investigation here is the 2,362 direct mail processing tallies for Nonprofit Standard Mail (A) Regular.

Table 9

IOCS Tallies for Nonprofit Standard Mail (A)
FY96

	Direct Mail Processing Tallies (1)	Admin/ Window Service Tallies (2)	Total (3)
Regular	2,362	31	2,393
ECR	171	4	175
Total	2,533	35	2,568

Source: LR-H-23.

Form of nonprofit mail handled. When mail is being handled at the time a tally is taken, the tally indicates whether the clerk was handling a single piece of mail, an item,[11] or a container.[12] This distribution is shown in Table 10.

[11] An item could be a bundle, a con-con, pallet, pouch, sack, or tray.

[12] A container is rolling stock, such as a hamper, APC or OTR.

Table 10
IOCS Tallies for Nonprofit Standard Mail (A) Regular
FY96

	No. of Tallies	Percent
Single Piece	1,517	64.2%
Item	824	34.9
Container	21	0.9
Total	2,362	100.0%

Source: LR-H-23.

Shape is always recorded (i) for a single piece of mail, (ii) when a top piece is sampled from an item such as a bundle or tray, and (iii) when all pieces in an item or container have the same shape. The rows of Table 11 show the shape and the columns show what the clerk was handling at the time the tally was taken.

Table 11

IOCS Tallies for Nonprofit Standard Mail (A) Regular
By Shape and Item
FY96

Shape	Single Piece (1)	Item (2)	Container (3)	Total (4)	Percent (5)
Card	24	17	0	41	1.74%
Letter	980	605	13	1,598	67.65
Flat	485	194	7	686	29.04
IPP	21	7	0	28	1.19
Parcel	7	1	1	9	.38
Total	1,517	824	21	2,362	100.00%

Source: LR-H-23.

Analysis of weight. For individual pieces, the IOCS tally assertedly shows the weight of the piece being handled at the time the tally is taken. For items, when all pieces are identical, the tally shows the weight of a representative piece; when not identical, the top-piece rule is followed.[13] For containers, the tally indicates the weight of a

[13] "Weight will only be recorded for an item tally if the tally contains identical mail or is subject to the Top Piece rule..." See written response of USPS Degen to oral questions of ANM (filed October 28, 1997).

typical piece if all mail in the container is identical.[14] Thus, in all instances where weight is recorded, it is supposed to be for a single piece of mail.

Table 12 shows the recorded weight for each of the 2,362 Nonprofit Standard Mail (A) Regular tallies. As shown there, 7 tallies record a weight in excess of 16 ounces, which is the maximum weight permitted within Standard Mail (A). For these 7 tallies, the recorded shape is also shown for informational purposes. Clearly, something is wrong with these 7 tallies. Either the weight is in error, or the tally has been misrecorded as being Nonprofit Standard Mail (A). In response to a hypothetical question about a piece of Standard Mail (A) whose weight exceeded 16 ounces, witness Degen responded as follows:[15]

> The F-45 handbook (LR-H-49) contains no specific instructions for the disposition of such a tally. Mail class is recorded in question 23b. The question 23b instructions indicate that the Third-Class/Standard Mail (A) categories apply to mailpieces weighing less than 16 ounces. Weight is recorded in question 23g. The instruction to question 23g (LR-H-49, p. 131) are simply to record the weight in pounds and ounces, rounded to the nearest ounce, for mailpieces weighing more than 4 ounces. ***It cannot be***

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[14] "If the contents of the container are identical mail, then the weight of the representative piece selected for question 22 and 23 responses is recorded. Otherwise, no weight is recorded for the container." Id.

[15] Written response of USPS witness Degen to oral questions of ANM (filed October 28, 1997).

determined from the hypothetical whether the mail class was misidentified or the weight was incorrectly entered. (Emphasis added)

In addition to the tallies that recorded weight in excess of 16 ounces, another 35 tallies recorded weight between half a pound and 16 ounces; see Table 13. To have so many heavyweight tallies in a subclass with an average weight of only 1.1 ounces (see Table 7) seems unusual, especially the three letter-shaped tallies, one of which was reported to weigh between 15 and 16 ounces.

In conclusion, at a minimum, all tallies in excess of 16 ounces are clearly in error, and these tallies should be disregarded when computing the cost of Nonprofit Standard Mail (A) Regular. At the same time, the existence of such tallies requires explanation. One possibility is that these heavier weight pieces were entered as Standard Mail (B) by well-known, widely-recognized nonprofit organizations, and the tally was reflexively (but incorrectly) recorded as Nonprofit Standard Mail (A). In any event, the fact that these anomalous tallies survive the editing process suggests that the IOCS tallies have serious reliability problems and confirms that misidentification of nonprofit mail is ocurring.

Table 12

Nonprofit Standard Mail (A) Regular
Distribution of Mail Processing Tallies
By Item and Weight

	Single Piece Tallies		Item Tallies		Container Tallies
No Weight recorded	0		29		0
Up to 1oz.	940		533		12
1 up to 2 oz.	282		141		5
2 up to 3 oz.	115		65		1
3 up to 4 oz.	106		22		2
4 up to 5 oz.	0		0		0
5 up to 6 oz.	37		19		0
6 up to 7 oz.	9		2		0
7 up to 8 oz.	0		0		0
8 up to 9 oz.	9		5		0
9 up to 10 oz.	0		0		0
10 up to 11 oz.	11		2		0
11 up to 12 oz.	0		0		0
12 up to 13 oz.	4		0		0
13 up to 14 oz.	0		0		0
14 up to 15 oz.	0		1		1
15 up to 16 oz.	1		1		0
2.5 up to 3.0 lbs.	1	IPP	0		0
3.0 up to 3.5 lbs.	0		1	letter	0
4.0 up to 4.5 lbs.	0		1	flat	0
4.5 up to 5.0 lbs.	1	IPP	1	flat	0
6.0 up to 7.0 lbs.	1	flat	0		0
over 15 lbs.	0		1	parcel	0
Total	1,517		824		21

Source: LR-H-23.

Table 13

Nonprofit Standard Mail (A) Regular
Distribution of Mail Processing Tallies
In Excess of 8 Ounces, by Shape

	Letters	Flats	Parcels and IPPs	Total
8 up to 9 oz.	1	9	4	14
9 up to 10 oz.	0	0	0	0
10 up to 11 oz.	1	8	4	13
11 up to 12 oz.	0	0	0	0
12 up to 13 oz.	0	2	2	4
13 up to 14 oz.	0	0	0	0
14 up to 15 oz.	0	1	1	2
15 up to 16 oz.	1	1	0	2
Total	3	21	11	35

V. MISREPORTING BY THE IOCS OF STANDARD MAIL (A) ENTERED BY NONPROFIT MAILERS

In ordinary manufacturing establishments, data on costs of production and volume manufactured tend to be produced concurrently. Postal Service data systems, however, do not work this way.

Revenue/volume data. For Standard Mail (A) revenues are collected through accounting records, while detailed volume data are captured by the PERMIT system (formerly the PERMIT/BRAVIS system). This system collects data provided by mailers on Form 3602 when they enter bulk mail.

Cost data. Aggregate mail processing costs are likewise determined from accounting records. Data for determining costs of processing individual subclasses, including bulk mail, are derived through the In-Office Cost System ("IOCS"), which is a stratified random sample of mail processing facilities throughout the country. The IOCS functions independently of the PERMIT system.

Need for synchronization. Because the two systems for recording volumes and costs function independently, it is essential that they be properly synchronized.

In its generic form, the problem is as follows: Whenever a piece of mail bears postage markings for one subclass or rate category, **no way exists** for an IOCS tally clerk to know whether the mail was actually entered in another subclass or rate category. IOCS tallies must be able to identify accurately the subclasses of mail *in the same manner* as the volumes and revenues are recorded. *When entry data (Form 3602s) and envelope markings do not coincide, the IOCS will attribute costs to one subclass, while the volumes and revenues will be recorded in another subclass.*[16]

The subclass that is credited with extra volumes but no extra costs (tallies) will have **a lower unit cost**, while the subclass that is assigned the extra cost (tallies) but gets no credit for the corresponding volume will have **a higher unit cost.**

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[16] This situation occurred in Docket No. R94-1, with respect to In-County Publications. Through a programming error, IOCS tallies distributed costs to **In-County** publications, while revenues and volumes from those same publications were recorded under **Regular rate** publications. The result was a sharp increase in the unit cost of In-County publications. The Postal Service may also have problems of this nature with respect to the various rate categories of First-Class Mail.

Non-Synchronization of Nonprofit Volumes and Costs Within Standard Mail (A)

When a qualified nonprofit organization enters nonprofit bulk mail, it is duly recorded as such on a Form 3602-N for Permit Imprint mail or 3602-PN for metered or precancelled stamp mail. Evidencing of postage on all such mail will indicate "Nonprofit."[17] Thus, should it be the subject of a random tally under the IOCS, the tally (and cost) would be charged appropriately to nonprofit mail. At the same time, as a convenience to nonprofit mailers, the Postal Service has for many years and on a systematic basis allowed qualified nonprofit organizations to enter mail at the old Bulk Regular Rate ("BRR") under their nonprofit permit. Prior to 1991, nonprofit mailers had little incentive or need to use the regular rate, and qualified nonprofit organizations seemingly made little use of the commercial rate prior to 1991. Consequently, integrity of the Postal Service's data systems was not threatened or undermined if and when a nonprofit organization occasionally entered a mailing at the regular rate during those earlier years.

In 1990, Congress enacted P.L. 101-509 which prohibited qualified nonprofit organizations from including in mail entered at

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[17] Distinctive nonprofit stamps or meters may be used, but most nonprofit mail is believed to be entered with a preprinted indicia.

special nonprofit rates any offers for unrelated travel or insurance or financial services (e.g., credit cards). Subsequently, in late 1993, additional eligibility restrictions were placed on nonprofit bulk mail when Congress enacted P.L. 103-123, known as the Revenue Forgone Reform Act.[18] The Postal Service issued Publication 417, the first Postal Service handbook explaining new restrictions under the Revenue Forgone Reform Act, on or about October 1, 1995 (significantly, at the beginning of FY96, the Base Year in this docket). Also, during FY96 the Postal Inspection Service undertook rigorous enforcement of the new regulations.[19] As a result of the aforementioned changes in law and administrative enforcement in FY96, three different but related situations exist where mail originated by nonprofit organizations may be recorded as regular rate for purposes of counting volume and revenues, but recorded as nonprofit mail if subject to an IOCS tally.

First, on an after-the-fact basis, various mailings by a number of nonprofit organizations are known to have been assessed the difference between (i) the postage originally paid at nonprofit rates when the mail

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[18] Codified at 39 U.S.C. §3626(j)(1)(D), on May 5, 1995.

[19] The USPS Inspector General Semiannual Report to Congress, FY 1997, Volume 1, cites 79 Revenue Investigations against nonprofit organizations during the six-month period October 1, 1996 to March 31, 1997.

was entered as nonprofit mail (and bore evidence of its status as nonprofit mail), and (ii) the regular rate postage which the Postal Service subsequently deemed to be applicable. Although some of these assessments were reduced or withdrawn on appeal, many nonprofit organizations subsequently paid such assessments on mailings entered during FY96. The following questions thus arise:

- When assessments were collected, to which revenue account were they credited? Regular rate or nonprofit rate?

- Were the original 3602-Ns or 3602-PNs withdrawn (canceled), and an amended 3602-R or 3602-PR filed so as to credit the revenues and volumes to regular rate mail?

Mail in this first group clearly must have had nonprofit evidence of postage paid, since it was entered and delivered as nonprofit mail. If such mail were the object of an IOCS tally, then inevitably the tally (and the associated cost) would and should have been assigned to nonprofit mail, as the tally clerk could not possibly have known whether a particular piece of mail subsequently would be assessed additional postage.[20] However, if a revised or amended Form 3602 were filed, the volume would have been transferred to Standard Mail (A) in the

[20] This first case is speculative to the extent that ANM has been unable to ascertain from the Postal Service what adjustments (if any) are made to the data entry systems following collection of assessments.

PERMIT system so the costs would have been changed to Nonprofit Standard Mail (A) but the volume credited to Standard Mail (A).

Second, on other occasions nonprofit organizations may have prepared a mailing using nonprofit evidence of postage, only to have the Postal Service demand payment of the full regular rate before allowing the mail to be entered. In such cases, a revised 3602-R or 3602-PR (rather than a 3602-N or 3602-PN) would be filled out, thereby assuring that the PERMIT system will credit the volume and revenue to Standard Mail (A) rather than Nonprofit Standard Mail (A). However, since the mail was prepared for submission as a nonprofit mailing, the evidence of postage payment will be nonprofit. Should such mail be the object of an IOCS tally, inevitably and necessarily it will be recorded as nonprofit mail. Once again, Standard Mail (A) will be credited with the volume, while Nonprofit Standard Mail (A) will be charged with the cost. This instance differs from the prior one in that the outcome is not speculative; *i.e.*, this situation is known to have occurred, and is not speculative.

Third, as nonprofit organizations became aware of the various types of solicitations that could not be included in nonprofit mail as a result of the 1990 and 1993 enactment of nonprofit eligibility requirements, many nonprofit organizations began entering mail of this kind at commercial rates, accompanied by a Form 3602-R or 3602-PR.

To the extent that the envelope had nonprofit permit (indicia) or some other nonprofit evidencing of postage, (e.g., stamps or metered), but were submitted a Form 3602-R or 3602-PR, the integrity of the Postal Service's data systems was (and continues to be) systematically undermined.[21] Like the second situation discussed above, it is also known to have occurred. It is not speculative.

The initial cost and volume data are primary inputs to many other modeling efforts, including the roll-forward model. When these fundamental data become unsynchronized, the results of the extensive modeling efforts relied upon by the Commission and the Postal Service for rate making become unreliable.

Empirical Evidence of Mail Entered at Commercial Rates with Nonprofit Evidence of Postage Payment

To investigate the extent to which the sharp increase in Nonprofit Standard Mail (A) Regular unit costs may have resulted from revenue and cost data being "out of sync," the Alliance of Nonprofit Mailers has undertaken a survey of nonprofit organizations. A summary of the

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[21] Form 3602-N or 3602-PN is used to enter nonprofit bulk mail. Commercial rate mailers use either Form 3602-R or 3602-PR. To help distinguish clearly between the two, the discussion will refer to Form 3602-N for nonprofit mail and Form 3602-R for commercial mail.

results of that survey follow. Additional details are contained in Exhibit 1 ANM-T-1. Of 49 responses received as of the date this testimony was prepared:

- 11 organizations paid commercial rates and used regular rate indicia.
- 20 organizations paid commercial rates and used nonprofit evidencing of postage.
- 18 organizations entered nonprofit mail at nonprofit rates and with nonprofit markings, but later were assessed regular rates. Of those 18 mailings, at least 5 organizations were certain that they filed a corrected USPS Form 3602-R.

The responses come from all major geographic areas of the United States, which indicates that the phenomenon of using nonprofit evidencing on Standard Mail (A) is indeed widespread.

Estimate Volume and Inflation of Nonprofit Cost From Misidentifying Mail As Nonprofit

The total volume of bulk mail for fiscal years 1980-1996 is reproduced in Table 14. From 1980 to 1992, the volume of nonprofit mail grew from 7,964 to 11,999 million pieces. This growth of 4,035 million pieces represents a compound annual growth rate of approximately 3.5 percent over the 12-year period. Since 1992, the growth of nonprofit bulk mail has been almost stagnant, while

commercial rate bulk mail has grown remarkably, by almost 9 billion pieces. Without any doubt, some of the growth in commercial rate mail has been fueled by nonprofit organizations entering mail at the commercial rate. Trouble is, much of this mail has nonprofit evidencing of postage paid and, through the IOCS, costs of processing this mail are attributed to the nonprofit subclass, while volumes are credited to Standard Mail (A). I estimate that, since 1992, mail from nonprofit organizations has grown as follows:

	Pieces (millions)
1992 Volume of Nonprofit Mail	11,999
Growth in Nonprofit Mail, 1992 - 96	210
1996 Volume of Nonprofit Mail	12,209
Mail entered at commercial rates by qualified nonprofit organizations:	
With nonprofit evidencing	1,040
With regular rate evidencing	520
Total volume of bulk mail entered by nonprofit organizations	13,769

The total growth in volume of nonprofit bulk mail between 1992-1996 is estimated at a 3.5 percent annual compound rate. Of the total volume which paid regular rates, either at the time of entry or by

retroactive assessment, I estimate that at least two-thirds had nonprofit evidencing of postage paid. On this basis, the total volume of bulk mail with nonprofit evidencing of postage paid in fiscal year 1996 was as follows:

	Volume (millions)	Distribution (%)
Entered at nonprofit rate	12,209	92.15%
Entered at commercial rate	1,040	7.85
	13,249	100.00%

Since the IOCS is a random sample, it is reasonable to infer that 7.85 percent of all valid mail processing tallies, as well as the mail processing costs arising from those tallies, have been incorrectly attributed to nonprofit mail, and instead should have been attributed to commercial rate bulk mail. I therefore recommend that the Commission adjust mail processing costs, including piggybacks, attributed to Nonprofit Standard Mail (A) in this proceeding accordingly.

Conclusion

On the basis of empirical data gathered to date, the Postal Service's volume and cost data for Standard Mail (A) are clearly out of sync. It is clear that many nonprofit organizations have in fact paid

commercial rate postage for mail which bore evidence of nonprofit postage. Accordingly, such mailings doubtless have been recorded (appropriately) as regular rate volume. At the same time, any costs arising from any IOCS tallies of this mail would have been charged incorrectly (and admittedly inadvertently) to nonprofit mail. In this way, nonprofit costs have been and are being systematically overstated by the Postal Service's data systems.

Table 14

Third-Class Bulk Mail Volume
(millions of pieces)

Fiscal Year	Nonprofit (1)	Regular (2)	Total (3)
1980	7,964	21,997	29,961
1981	8,566	24,706	33,272
1982	9,064	27,452	36,516
1983	9,381	31,186	40,567
1984	10,372	37,699	48,070
1985	10,976	41,026	52,002
1986	10,888	44,006	54,894
1987	11,022	48,553	59,575
1988	11,249	51,789	63,038
1989	11,857	50,731	62,588
1990	12,028	51,509	63,537
1991	11,956	50,267	62,222
1992	11,999	50,354	62,353
1993	11,958	53,629	65,587
1994	11,900	57,327	69,237
1995	12,266	58,705	70,971
1996	12,209	59,331	71,686

Source: LR-H-187.

VI. OVER-ATTRIBUTION OF TRANSPORTATION COSTS TO STANDARD (A) NONPROFIT MAIL

Between FY95 and FY96, the increase in purchased transportation costs attributed to Nonprofit Standard Mail (A) Regular amounted to $11,451,000, which represented an astounding increase of 29 percent over FY95 (see Table 8). Total volume of Nonprofit Standard Mail (A) Regular was up only 0.8 percent, the percentage drop shipped increased by 2 percent (see Table 6), and the volume variability of total transportation costs did not change between FY95 and FY96. So, what is the explanation for such a sharp, disproportionate increase in transportation costs attributed to Nonprofit Standard Mail (A) Regular?

Transportation costs attributed to the individual classes and subclasses of mail are a direct result of the distribution key that is developed by TRACS. The distribution key represents the proportion of cubic foot miles that TRACS allocates to each subclass of mail. The cubic foot miles from TRACS are thus the basis for developing transportation costs attributable to each subclass. Accordingly, one must examine TRACS to see how such a result could occur.

How TRACS Works

TRACS is a sampling system. Postage evidencing on mail pieces may be used to determine the subclass of mail. Consequently, TRACS suffers the same drawback as IOCS when nonprofit evidencing is used on mail entered at commercial rates. That is, whenever such mail is sampled, the nonprofit subclass will be tagged with the transportation costs, while the regular rate subclass is credited with the volume and revenues.

The purpose of TRACS is to develop a key for distributing volume variable transportation costs to the individual classes and subclasses of mail. TRACS is a sampling system, and it samples mail from all the different modes of postal transportation: air, highway, rail and water. The vast majority of Nonprofit Standard Mail (A) is moved by surface transportation, the majority of which consists of highway services.

For highway transportation, TRACS samples mail as it is off-loaded from randomly selected trucks. At first blush, one might think that TRACS would distribute highway transportation costs according to:

- the ***actual amount of mail*** off-loaded: and
- the transportation service provided to whatever mail is found to have been off-loaded from the truck.

Unfortunately, TRACS does not achieve either of the above results. As explained below, TRACS treatment of highway transportation costs is fatally flawed in at least two important respects.

First, TRACS artificially breaks each truck's route into separate "independent" segments. Most highway routes involve round-trips, whereby trucks return to the facility from which they initially start the route.[22] On any given day, all segments of the route are necessarily served by the same truck. Capacity of the truck must obviously be sized for whatever segment or segments have the highest average volume. In other words, for operational planning purposes, as well as from an economic perspective, the route is an integral, indivisible unit. As stated by witness Bradley,[23]

> For the Postal transportation network, I view **the cost of a contract being jointly determined by the cost of serving all of the legs on all of the route/trips** on the contract. The cubic foot-mile capacity set on a contract reflects the **joint requirements** of moving mail over the Postal network and that **the total contract cost should not be allocated to any individual leg on the contract.** In other words, the cost of transportation on a contract varies with changes in the *total* cubic foot-miles specified in the contract and **is not directly allocable to any specific leg.**

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[22] The truck may go out and back, more or less traversing the same route, or it may make a "circular" trip that does not entail retracing any segment in opposite directions.

[23] FGFSA/USPS-T13-25, Tr.7/3337.

> Moreover, contract specifications are set by the Postal Service in its attempt to minimize highway transportation costs subject to reliably meeting service standards. (emphasis added)

Witness Bradley is correct, and I concur fully.[24] In other words, the route should not be broken up artificially into "independent" segments. Yet this is precisely what TRACS does.

Second, TRACS is built upon an indefensible "expansion" process that distorts and biases the final distribution key by an unknown magnitude.

The "expansion" process explained. In fact, TRACS neither measures nor records the actual volume of mail (in terms of pieces, pounds or cube) that is off-loaded. Instead, through a series of steps or data manipulations, the total space available is allocated to whatever mail that happens to be off-loaded from the truck at the time when the truck is sampled. In so doing, TRACS *expands* the sampled mail ***to fill the entire space available***, regardless of the amount of mail actually on the truck.

To illustrate, assume that an over-the-road ("OTR") container is sampled upon off-loading. It may have in it only one or two sacks of

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[24] Under cross-examination, witness Nieto professed to agree fully with witness Bradley. Tr.7/3518.

nonprofit mail. Alternatively, it might be loaded full to the brim with nonprofit mail. So long as the OTR container has only nonprofit mail, it would be recorded as having 100 percent nonprofit mail.[25] This is the case even if the container is practically empty and the remainder could just as easily have been filled with something else, such as regular rate bulk mail, or parcels, or whatever. In other words, the nonprofit mail in the OTR container is treated by TRACS as somehow having been responsible for whatever empty space happens to be found in the OTR at the time the sample is taken. On this basis, TRACS treats the empty space in the container as "reasonably assignable" to the nonprofit mail in the container. Finally, as indicated previously, the actual volume of mail is not recorded, hence that most essential datum is simply not available in the TRACS database.[26]

To continue the preceding example, the TRACS expansion process does not end with the OTR container. The expansion process continues its "blame the victim" procedure until all available cube on the truck is assigned to whatever mail happens to be off-loaded from the

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[25] Tr.7/3493, 3495.

[26] The lack of this datum makes it impossible to use the TRACS data base to develop an alternate distribution key based on actual volumes of sampled mail, and transportation services provided to sampled mail.

truck, no matter how small or large the actual volume of mail. At the point where the sample is taken, the truck may be almost empty, but the expansion process nevertheless attributes all the empty space for that particular segment (as well as prior segments) to whatever mail is actually sampled.[27]

Bizarre results from the expansion process. TRACS' expansion process is capable of producing absolutely bizarre results. The ratio of (i) the cubic volume attributed to a subclass and (ii) the actual volume of mail on the truck can vary enormously. If the truck is practically full, the ratio will be low, perhaps less than 2 to 1. If the truck is nearly empty, however, the ratio could be quite large, perhaps exceeding 100 to 1, by virtue of the empty volume assigned to mail on the truck.[28] In other words, the emptier the vehicle, the greater the cube apportioned to the actual volume of mail that happens to be off-loaded from the truck.

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[27] Assume a truck is 20 percent full and three-fourths of the mail on the truck is off-loaded. Then three-fourths of the 80 percent empty capacity is "reasonably assigned" to the off-loaded mail. In this example, mail occupying 15 percent of the truck is assigned 75 percent of the total capacity of the truck for that segment.

[28] Tr.7/3504. TRACS evidence ratios of expanded cubic feet to actual feet that are well in excess of 100 to 1. FGFSA/USPS-T2-50, Tr.7/3323, 3325.

On those segments that have low capacity utilization on a regular recurring basis, the cubic volume assigned to the distribution key will be inversely proportional to the actual volume of mail off-loaded from the truck. In other words, the ultimate cost that is attributed (via the distribution key) for each unit of actual mail volume will be high. Should a particular class of mail travel regularly over a segment where the truck is largely empty, that class will be the victim of this weird procedure for always attributing the entire cubic volume of the truck. Moreover, rates will be designed to reflect these unit costs, even though they may be inversely related to actual usage.

In short, TRACS is an economist's nightmare come true. The emptier the vehicle, the greater the amount of cube (and, ultimately, the cost) charged to whatever subclasses of mail that happen to be on the truck. Recall that **TRACS breaks the route into independent segments**. On segments where trucks are largely empty, TRACS thus operates like a game of "Old Maid." Should volume diminish on a particular segment, until the only reaining mail on the truck is one sack or container, it gets "stuck" with the entire cube (and cost) of that particular segment (which is expanded up to the full year). It seems ironic that such an allocation procedure would be implemented by an

organization which favors cost-based rates coupled with demand pricing.[29]

Under TRACS, the assignment of empty space distorts the reality of what is actually being transported, and how much transportation services are actually being provided to, or consumed by, each subclass of mail. And on those occasions when trucks are largely empty, the distortion of reality can border on the grotesque.

In my opinion, the assignment of empty space is fundamentally wrong, because no causal nexus exists between (i) the subclasses of mail on the truck and transportation services provided to that mail, and (ii) empty space on the truck that is sampled. The preceding criticism of the expansion process should not in any way be interpreted to mean that

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[29] An analogy may help demonstrate the way TRACS assigns cubic-foot-miles that, ultimately, are reflected in "cost-based" rates. Suppose a ski resort spent $10 million on a lift that is being depreciated over 10 years; *i.e.*, $1 million per year. The average ski season at this resort lasts for 100 days, and on this basis the operator determines that depreciation of the lift costs $10,000 per day. A random sample is taken to ascertain usage of the lift. The first sample, on Tuesday, counts 100 skiers; the second sample, on Saturday, counts 1,000 skiers. Applying TRACS reasoning, people skiing on Tuesday are assigned a depreciation cost of $100 per skier, and for Saturday it works out to $10 per skier. Cost-based rates for each day of the week are set accordingly. If this result seems bizarre, we rationalize it by "reasonably assigning" all the empty chairs on Tuesday to those skiers who were counted and found to be utilizing the lift that day.

some alternative way of assigning empty space on specific legs of a specific trip to individual classes of mail would be better.

Potential for bias. With respect to the 29 percent increase in transportation cost between FY95 and FY96, the issue at hand is: Do systematic biases exist in the cubic volume assigned to each subclass when developing the distribution key? To address this issue, the following questions are pertinent.

- Do trucks systematically utilize more capacity in one direction?

The answer is clearly affirmative. Intra-BMC transportation, will be used to illustrate the point. Trucks bound **from** the BMC average significantly higher capacity utilization (and correspondingly less empty space) than trucks bound **to** the BMC (which have far more empty space). The substantial variation in utilization documented by TRACS results from the large volume of mail that is drop shipped to destination BMCs. In other words, a substantial volume of mail is transported from BMCs to destination SCFs, while originating volume traveling from SCFs to BMCs is comparatively light.

- Do some subclasses systematically drop ship less than others and, as a result, constitute more of the volume on trucks bound to BMCs?

Again, the answer is clearly affirmative. As between the two Standard Mail (A) Regular subclasses, only 25 percent of Nonprofit Standard Mail (A) Regular was drop shipped in FY96, versus 41 percent for Standard Mail (A) Regular; see Table 6, *supra.*[30]

Conclusion. TRACS is fatally flawed, as demonstrated above, but the solution seems obvious. TRACS needs to be revised so as to measure the ***actual volume of mail utilizing Postal Service transportation,*** and to develop distribution keys that incorporate only actual mail volumes. When that is done, TRACS will reflect the transportation services actually provided to each subclass of mail. TRACS should also treat the cost of serving an entire route as an individual unit.

Regrettably, under the circumstances of this case, it has not been possible to develop an alternative distribution key based on the volume of mail actually transported, and the transportation services that were utilized by each subclass of mail.

Given the data that are available from the TRACS sample data, the Commission could develop a distribution key that does not expand

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[30] Standard Mail (A) presorted to the 3/5-Digit category is over 8 times more likely to be drop shipped than Basic Mail. If TRACS were applied at the rate category level, it would contain substantial bias against Basic presort mail.

the sample beyond what the data collector initially records. That is, the expansion step or steps that unjustifiably assign absolutely empty floor space on the truck should be eliminated. This would be a step in the right direction.

December 29, 1997

SUBJ: Exhibit 1 - ANM-T-1
Responses to Survey of Alliance of Nonprofit Mailers
Survey Conducted December 16, 1997 - Current

PURPOSE: As outlined in the testimony of Dr. John Haldi, the ANM has come to recognize that a significant volume of mail marked as "nonprofit" actually paid Standard (A) Regular rates in FY 1996, the base year in Docket No. R97-1.

To better learn the scope of this phenomenon, on December 9, 1997 the ANM submitted seven interrogatories (ANM/USPS-20-26) to the Postal Service.

ANM/USPS- 20 sought to learn how much volume of "nonprofit" mail was forced to pay regular rates because "the Postal Service determined, before or during entry of the mail, that it did not qualify" for nonprofit rates.

ANM/USPS - 21 sought to learn how much nonprofit mail was retroactively found to require commercial rates of postage because material in the mailpiece disqualified it for nonprofit rates.

ANM/USPS - 25 sought to learn how data was revised on USPS Form 3602s after a "nonprofit" mailing was forced to pay commercial rates.

Because the Postal Service has objected to these interrogatories, and refused to hold a technical conference to assess what partial information is or may be available from the Postal Service, and because an understanding of this pattern is important to this proceeding, the ANM has undertaken to collect as much data as can be produced within the limited resources and time available.

KEY: All volumes reported in this survey are of Standard Mail (A) Regular that was entered by nonprofit organizations at the commercial rate, or that was subsequently assessed and paid the full commercial rate.

Column 1 represents the type of permit and subclass marked on the mailpiece.

Column 2 contains volumes of Standard (A) Regular rate mail sent by a nonprofit organization under **regular rate** markings because the mailpiece was ruled to contain ineligible material that disqualified it for nonprofit rates. [See ANM/USPS-20]

Column 3 contains volumes of Standard A Regular rate mail sent by a nonprofit organization with **nonprofit rate** markings but, because the mailpiece was ruled to contain ineligible material that disqualified it for nonprofit rates, commercial rates were actually paid. [See ANM/USPS-20]

Column 4 contains volumes of Standard (A) Regular rate mail sent by a nonprofit organization under **nonprofit rate** markings that were later ruled to contain ineligible material that disqualified it for nonprofit rates. Commercial rates of postage were retroactively assessed these volumes. [See ANM/USPS-21]

Column 5 represents the answer to the question: "for how many (if any) of the pieces identified" [in column 4] was a revised Form 3602 filed?

SURVEY: A sample survey is attached. It was faxed, e-mailed and mailed to hundreds of nonprofit mailers. (It is impossible to identify how many nonprofit executives received the survey because it was copied and recopied by other "umbrella" nonprofit organizations.) For surveys that were incomplete, phone calls were made to supplement the filing.

SUMMARY: (to be completed with final numbers)
At the time and point of entry:

Column 2 demonstrates that 11 organizations paid commercial rates and used regular rate indicia.

Column 3 demonstrates that 20 organizations paid commerical rates but used nonprofit markings.

Column 4 demonstrates that 18 organizations entered nonprofit mail at nonprofit rates and with nonprofit markings, but later were assessed regular rates. Of those 18 mailings, at least 5 organizations were certain that a corrected USPS Form 3602-R had been filed.

OTHER NOTES:

- The respondents to this survey come from a wide mix of states and regions and differ in size from large national nonprofits to small, community-based nonprofit care providers.

- Because of the holiday season, responding organizations are having difficulty assembling all of the necessary information. More data are expected in the coming weeks after December 30, 1997.

	(1a)	(1b)	(2)	(3)	(4)	(5)
	Permit Used		POSTAGE ORIGINALLY PAID			
			STANDARD MAIL (A)		NONPROFIT STANDARD MAIL (A)	
			STD MAIL(A) INDICIA	NP STD MAIL(A) INDICIA	VOL OF NP STD MAIL (A)	WITH NEW (REVISED) FORM 3602
1	NP	indicia			15,000	yes
2	REGULAR	indicia	50,000			
3	REGULAR	indicia	22,291			
4	NP	Indicia/meter				
5	NP	indicia/meter				
6	np	indicia			1,000,000	no
7	NP	indicia			5,300,000	no
8	NP	meter		15,000		
9	NP	Indicia/meter		45,641	6,050	no
10	NP	meter		2,726		
11	NP	indicia/meter		25,000		
12	NP	indicia/meter		1,200		
13	NP	indicia			500	no
14	NP	indicia/meter		10,000	10,000	yes
15	NP	indicia		20,000		
16	REGULAR	indicia	46,708			
17	REGULAR	indicia	30,000			
18	REGULAR	indicia	2,100			
19	NP	indicia			560	yes
20	REGULAR	indicia	750,000			
21	NP	indicia			400,000	yes
22	NP	indicia/meter		102,170		
23	NP	indicia		2,500	5,000	no
24	NP	indicia		15,000		
25	REGULAR	indicia	15,000			
26	NP	indicia			1,081,278	no
27	NP	Indicia		7,800		
28	NP	indicia		9,912		
29	NP	unk		800		
30	NP	meter		100,000		
31	NP	indicia/meter				
32	NP	indicia			118,500	unk
33	NP	indicia			16,000	unk
34	NP	Indicia		30,000	370	unk
35	NP	indicia			65,000	no
36	NP	indicia				
37	NP	indicia		168,000		
38	NP	indicia		23,578		
39	REGULAR	meter	26,000			
40	REGULAR	indicia/meter	40,000			
41	REGULAR	indicia/meter	30,000			
42	NP	indicia			620	unk
43	NP	indicia		925		
44	NP	indicia		2,900		
45	REGULAR	indicia/meter	20,000			
46	NP	indicia			11,000	no

47	NP	indicia			100,000	unk
48	NP	indicia			200,000	yes
49	NP	indicia		3,500		
	SUBTOTALS		1,032,099	586,652	8,329,878	

ALLIANCE OF NONPROFIT MAILERS

MEMO: December 17, 1997
TO: Members and Friends of the Alliance of Nonprofit Mailers
FROM: Neal Denton, Executive Director
SUBJ: Important Request to Provide Information for Rate Case

For those of you that read the regular *Alliance Report*, you know that the ongoing postal rate case litigation before the Postal Rate Commission threatens to hit nonprofit Standard A mailers with substantial increases. For some members and friends, the rate increases could be as high as 15-18%.

In order to best protect your interests and the interests of your colleagues in this critical coalition — we urgently need your response to the important questions listed below. After learning some very important information from an earlier set of questions, our Litigation Team needs this follow-up information in order to present our best defense before the Postal Rate Commission.

Could you please take personal responsibility to see that these questions are answered and that this page is faxed back to the Alliance office AS SOON AS POSSIBLE? At the very least, please try to have these responses back to us by Monday, December 22 (fax 202-462-0423).

Organization:_____ Date:_____

Address:_____ Does your organization use Fiscal Year or Calendar Year volume data? (Please circle one)

Name of contact:_____

Telephone No._____ Email Address_____

I. 1996 Bulk Mailings

1. How many pieces of mail did your organization enter at the Standard A **nonprofit rates** (or the old third-class nonprofit rates) during Fiscal Year 1996 (i.e., from October 1, 1995 to September 30, 1996)?

2a. How many pieces of mail did your organization enter at the Standard A **regular (commercial) rates** (the old third-class regular, bulk rates) in FY 96?

2b. For mail entered at the Standard A regular rates (the old third-class regular, commercial bulk rates), what permit was used?

nonprofit permit_____ regular Rate permit_____

2c. For mail that your organization sent at the Standard A regular rate [the old third-class regular, bulk (commercial) rates], what postal indicia did the organization use?

	Nonprofit	Regular rate
Indicia	_____	_____
Stamps	_____	_____
Meter	_____	_____

3. Why did your organization enter mail at the Standard A regular rates (the old third-class regular, bulk rates)?

   - Because your organization decided that the mail was ineligible for the nonprofit rates?
   - Because the Postal Service had told your organization that this mail did not qualify for the nonprofit rates?

II. Mailings Retroactively Assessed

5. Did your organization enter at the Standard A (formerly third-class) nonprofit rates any mail that was later determined by the Postal Service not to qualify for the nonprofit rates?

6. Did you appeal the assessment?

7. What was the result of the appeal?

8. For how many pieces of mail entered at nonprofit rates in Fiscal Year 1996 did you ultimately pay the difference between nonprofit and commercial postage?

9. For how many (if any) of the pieces identified in response to Question 8 did you file a revised Form 3602?

III. Mailings Under Reclassification

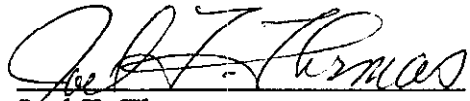
10. How many pieces of mail, if any, was your organization permitted to enter at the Standard A nonprofit ECR (Enhanced Carrier Route) rates after the effective date of reclassification, (October 6, 1996) that failed to meet all the post-reclassification mail preparation requirements? In other words, for how much mail did the Postal Service waive some or all of the requirements for ECR rates?

PLEASE FAX TO THE ALLIANCE OF NONPROFIT MAILERS AT 202-462-0423. YOUR PROMPT ATTENTION TO THIS SURVEY WILL ASSIST IN REPRESENTING THE INTERESTS OF NONPROFIT MAILERS IN THE CURRENT USPS RATE CASE.

Thank you for your time.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.



Joel T. Thomas

December 30, 1997